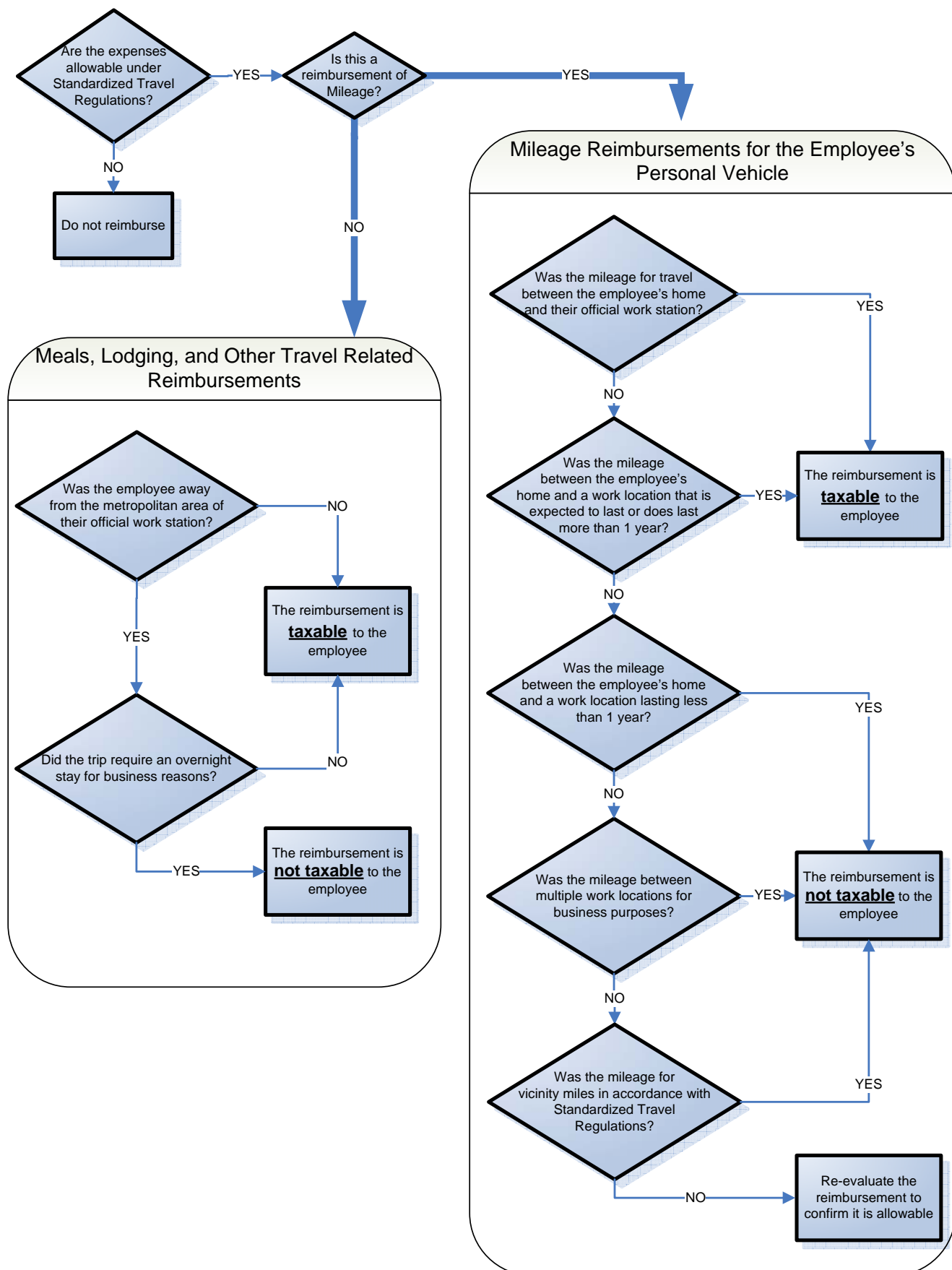


Determining the Tax Treatment of Expense Reimbursements



IRS DEFINITIONS AND CONCEPTS

Taxation of Employee Expense Reimbursements

Accountable plan

An accountable plan is an allowance or reimbursement policy under which amounts are nontaxable to the recipient if the following requirements are met:

- There must be a *business connection* to the expense.
- There must be adequate accounting by the recipient within a reasonable period of time. IRS Safe Harbor rules for a reasonable period of time indicate the reimbursement must be substantiated within 60 days of the date the expense was incurred.
- Excess reimbursements or advances must be returned within a reasonable period of time. IRS Safe Harbor rules for a reasonable period of time indicate the excess reimbursements or advances must be repaid within 120 days of the date the expense was incurred or the advance was issued.

Away from home

Employees are considered to be traveling away from home if the business duties require them to be away from their *tax home* for longer than an ordinary day's work and, during that time, they need sleep or rest in order to meet the demands of employment.

Business connection

There must be a business purpose for an employee's travel that can be supported by documentary evidence in order to consider treating the reimbursement of travel expenses as non-taxable. Further, to meet the business connection requirement of an *accountable plan*, travel expense reimbursements other than mileage are only nontaxable to the extent that the expenses are incurred when the employee is *away from home* as defined by the IRS (see above).

Permanent work location

The IRS defines a permanent work location as one that is expected to last or does last more than 1 year. If at the point of assignment, it is known that the assignment will span more than one year, the work location is viewed by the IRS as a permanent work location for the duration. If it is not known, it does not become a permanent work location until 12 months have passed.

Reimbursement of meals and lodging expenses are considered taxable fringe benefits if the expenses are incurred at a permanent work location. Reimbursement of mileage between the home and a permanent work location is taxable. Reimbursement of mileage between multiple work locations is non-taxable provided there is a business need for the travel.

IRS DEFINITIONS AND CONCEPTS

Taxation of Employee Expense Reimbursements

Substantiation requirements

IRS substantiation requirements provide that the employee must document the date, time, place, amount, and business purpose of expenses. Other than approved per diem reimbursements made within federal rates and guidelines, employees should have documentary evidence, such as bills, receipts, canceled checks, or similar items to support their claimed expenses.

Tax Home

The Internal Revenue Code permits treating a reimbursement for travel expenses as non-taxable if expenses are incurred while the employee is away from his or her tax home. In most cases, the employee's tax home is the general vicinity of his or her principal place of business. Whether the main place of work is the employer's business office or the taxpayer's residence, the tax home includes the entire metropolitan area; therefore, the taxpayer is not away from home unless he or she leaves the metropolitan area.

In some circumstances, an employee may have multiple tax homes (more than one *permanent work location*). When an employee is at any of these *permanent work locations* he or she is not considered *away from home* for the purpose of treating meals and lodging expense reimbursements as non-taxable.

IRS regulations provide a special election for state legislators who attend legislative sessions away from the area of their residence. This election allows a state legislator to designate his or her personal residence as his or her tax home with respect to the trade or business of being a legislator. The election is only available to legislators whose place of residence is more than 50 miles from the state capitol.

Temporary work location

The IRS defines a temporary work location as one that is expected to last and does last less than 1 year.